

**TITLE 2. ADMINISTRATION
DIVISION 7. SECRETARY OF STATE
NOTICE OF PROPOSED RULEMAKING**

Notice is hereby given that the Secretary of State intends to adopt the proposed regulations described below after considering all comments, objections, and recommendations regarding the proposed action.

PROPOSED REGULATORY ACTION

Assembly Bill 55, Chapter 1015, Statutes 2002 amended Sections 1502 and 2117 and added Section 1502.5 of the Corporations Code. Subdivision (i) of Section 1502 and subdivision (d) of Section 2117 require domestic stock corporations and qualified foreign corporations to pay a five-dollar (\$5) disclosure fee in addition to any other fees required when filing the statement disclosing specified information concerning its operation. One-half of the fee shall be deposited into the Victims of Corporate Fraud Compensation Fund in the State Treasury established in Section 1502.5. Section 1502.5 further states that the fund shall be administered by the Secretary of State who shall adopt regulations regarding the administration of the fund and the eligibility of victims to receive compensation from the fund. The revenue in the fund shall be used for the sole purpose of providing restitution to the victims of corporate fraud.

The Secretary of State proposes to add Chapter 12, consisting of Sections 22500, 22501, 22502, 22503, 22504, 22505, 22506, 22507, 22508, 22509, 22510, 22511, 22512, 22513, 22514, 22515, 22516, 22517, 22518, and 22519 to Division 7 of Title 2 of the California Code of Regulations. These sections establish the procedures for administering the fund and criteria for eligibility to receive compensation from the fund, including, but not limited to, the following: the definitions of terms used in the Chapter; the formats of the application, notice, response, and decision; the notice requirements; the rights of claimants, judgment debtors, and the Secretary of State; the proration of claims; the appeal procedures; the maximum limit of payments; and the recovery of payments from corporations named as judgment debtors.

PUBLIC HEARING

The Secretary of State has scheduled a public hearing on the proposed action. The public hearing will be held on September 23, 2003 from 9:00 a.m. to noon in the Multipurpose Room at the Office of the Secretary of State, 1500 11th Street, Sacramento, California. The facility is wheelchair accessible. At the public hearing both oral and written statements, arguments, and contentions shall be permitted.

WRITTEN COMMENT PERIOD

Any interested person, or his or her authorized representative, may submit written comments relevant to the proposed regulatory action to the Secretary of State. The written comment period closes at 5:00 p.m. on September 23, 2003. Only written comments received at the Office of the Secretary of State by that time shall be considered. Submit written comments to the contact person listed below.

AUTHORITY AND REFERENCE

Section 1502.5 of the Corporations Code authorizes the Secretary of State to adopt rules to facilitate the administration of the Victims of Corporate Fraud Compensation Fund and the eligibility of victims to receive compensation from the Victims of Corporate Fraud Compensation Fund. The proposed regulations would implement, interpret and make specific Section 1502.5 of the Corporations Code.

INFORMATION DIGEST AND POLICY STATEMENT OVERVIEW

Assembly Bill 55, Chapter 1015, Statutes 2002 amended Sections 1502 and 2117 and added Section 1502.5 of the Corporations Code. Subdivision (i) of Section 1502 and subdivision (d) of Section 2117 require a domestic stock corporations and qualified foreign corporations to pay a five-dollar (\$5) disclosure fee in addition to any other fees required when filing the statement disclosing specified information concerning its

operation. One-half of the fee shall be deposited into the Victims of Corporate Fraud Compensation Fund in the State Treasury established in Section 1502.5. Section 1502.5 further states that the fund shall be administered by the Secretary of State who shall adopt regulations regarding the administration of the fund and the eligibility of victims to receive compensation from the fund. The revenue in the fund shall be used for the sole purpose of providing restitution to the victims of corporate fraud.

The Secretary of State has no previous expertise or experience in administering a fund for victims of fraud. Sections 1502, 1502.5 and 2117 of the Corporations Code do not establish the parameters or framework for the fund. In drafting the proposed regulations the Secretary of State looked at the Real Estate Recovery Account administered by the Department of Real Estate, which provides compensation to members of the public who have been defrauded by real estate licensees.

The Secretary of State proposes to add Chapter 12, consisting of Sections 22500 through 22519 to Division 7 of Title 2 of the California Code of Regulations. Section 22500 would define the terms used in Chapter 12. Section 22501 would establish the application procedures for payment from the Victims of Corporate Fraud Compensation Fund. Section 22502 would establish the form of the application and define terms for the purpose of applications based on criminal restitution orders. Section 22503 would establish notice requirements and the form of the notice. Section 22504 would establish the requirements and form of the response by a judgment debtor. Section 22505 would establish the addresses at which all parties shall be served with subsequent correspondence and notices after the initial application is submitted to the Secretary of State, served on the judgment debtor, and service of any response by the judgment debtor. Section 22506 would establish the procedures for notifying a claimant of deficiencies in an application, correcting deficiencies, resubmitting the application, and authorizing the Secretary of State to deny an application if the claimant does not respond to the notice of deficiencies. Section 22507 would establish application deadlines that will determine what fiscal year a payment will be made and that the payment of claims shall not exceed the total amount of funds available for the fiscal year in the Victims of Corporate Fraud Compensation Fund. Section 22508 would establish the deadline for the Secretary of State to render a final decision on an application, unless the claimant agrees to extend the deadline, authorize the Secretary of State to deny, grant or enter into a compromise to pay less than the amount in the application, and provide means of investigation and discovery under Article 2 (commencing with Section 11180) of Chapter 2 of Part 1 of Division 3 of Title 2 of the Government Code. Section 22509 would establish the procedures and form of the decision rendered by the Secretary of State. Section 22510 would provide the procedures in the event that a judgment debtor files a Writ of Mandamus. Section 22511 would establish the proration where the aggregate valid applications of all aggrieved persons exceed the funds available for distribution from the Victims of Corporate Fraud Compensation Fund. Section 22512 would establish the procedures for a claimant to appeal a decision of the Secretary of State denying claimant's application. Section 22513 would establish procedures whenever a court proceeds upon an application. Section 22514 would establish the rights of a judgment debtor. Section 22515 would establish a limit of a payment to twenty thousand dollars (\$20,000) for any one transaction. Section 22516 would require a corporation named as a judgment debtor to pay the Victims of Corporate Fraud Compensation Fund the amount of the claim paid out of the fund plus interest at the time the corporation files its next statement of information pursuant to Section 1502 of the Corporations Code and if the corporation does not pay the fund it shall be suspended as set forth in Section 2204, 2205 or 2206 of the Corporations Code. Section 22517 requires the Secretary of State to deposit any sums received pursuant to this Chapter in the State Treasury and credit said sums to the Victims of Corporate Fraud Compensation Fund. Section 22518 would require all of a claimant's rights, title, and interest in a judgment to be assigned to the Secretary of State when the Secretary of State has paid the claimant from the Victims of Corporate Fraud Compensation Fund. Section 22519 would establish that the failure of an aggrieved party to comply with all of the provisions of this Chapter shall constitute a waiver of any rights hereunder.

AVAILABILITY OF THE TEXT IN PLAIN ENGLISH

The text of the proposed regulations is available in plain English from the contact person listed below.

DISCLOSURE REGARDING THE PROPOSED ACTION

The Secretary of State has made the following determinations:

- Mandate on local agencies and school districts: None.
- Cost or savings to any state agency: The proposed regulations result in a cost to the Secretary of State. Section 1502.5 of the Corporations Code establishes the Victims of Corporate Fraud Compensation Fund, however, the statute is silent as to the parameters and framework of the program. The Legislature charged the Secretary of State with defining the program through the regulatory process. The proposed regulations provide for comprehensive procedures for administering the fund and determining the eligibility of victims to receive compensation from the fund. The Secretary of State currently anticipates the need for three new staff positions to administer the program as it is established in the proposed regulations.
- Cost to any local agency or school district, which must be reimbursed in accordance with Section 17561 of the Government Code: None.
- Other non-discretionary cost or savings imposed upon local agencies: None.
- Cost or savings in federal funding to the state: None.
- Significant, statewide adverse economic impact directly affecting business, including the ability of California business to compete with businesses in other states: Minimal. The Victims of Corporate Fraud Compensation Fund provides an avenue for victims of corporate fraud to satisfy judgments or arbitration awards against corporations that have committed corporate fraud. The Secretary of State shall then pursue corporations named as judgment debtors for reimbursement of all monies paid from the Victims of Corporate Fraud Compensation Fund. The failure to reimburse the fund for claims paid plus interest shall result in the suspension of all corporate powers, rights, and privileges as set forth in Section 2204, 2205 or 2206 of the Corporations Code. A suspended corporation shall not conduct business. The suspension shall end when the corporation submits the reimbursement to the Secretary of State.
- Cost impacts that representative private persons or businesses would necessarily incur in reasonable compliance with the proposed action: Minimal. The costs associated with satisfying the requirements for payments from the Victims of Corporate Fraud Compensation Fund under the proposed regulations are not believed to be any more costly than pursuing other avenues to enforce judgments or arbitration awards against corporations. The Victims of Corporate Fraud Compensation Fund provides a resource for satisfying judgments and arbitration awards. Judgment debtors that do not reimburse the Victims of Corporate Fraud Compensation Fund as required shall have all corporate powers, rights, and privileges suspended as set forth in Section 2204, 2205 or 2206 of the Corporations Code. During the suspension, the corporation shall not be authorized to conduct business. The suspension shall end when the corporation submits the reimbursement to the Secretary of State.
- Adoption of these regulations will not do any of the following: (1) create nor eliminate jobs within California with the exception of the need for three new staff positions to administer the program as it is established in the proposed regulations; (2) create new business or eliminate existing business within California; nor (3) affect the expansion of business currently doing business within California.
- Significant effect on housing costs: None.

BUSINESS REPORTING REQUIREMENT

The business reporting requirement is not applicable to the proposed regulations.

SMALL BUSINESS DETERMINATION

The proposed regulations would impact any corporation against which a judgment, arbitration award, or criminal restitution order has been entered for conduct constituting intentional fraud and where a claim has been filed with the Secretary of State. As of July 5, 2003 there were 809,812 active corporations in California, including 576,514 domestic stock corporations, 147,159 domestic nonprofit corporations, and 86,139 qualified foreign corporations. The Secretary of State is unable to determine how many of these corporations are defined as small businesses, as all professions, industries, services, and trades with various annual gross receipts are represented in the California corporate community.

CONSIDERATION OF ALTERNATIVES

The Secretary of State does not have previous expertise or experience in administering a fund such as the Victims of Corporate Fraud Compensation Fund. Sections 1502, 1502.5 and 2117 of the Corporations Code do not establish the parameters or framework for the fund. In drafting the proposed regulations the Secretary of State looked at laws and regulations governing the Real Estate Recovery Account administered by the Department of Real Estate, which provides compensation to members of the public who have been defrauded by real estate licensees.

The agency must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which this action is proposed, or be as effective and less burdensome to affected private persons than the proposed action.

AVAILABILITY OF STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATIONS

The Secretary of State shall have the entire rulemaking file available for inspection and copying throughout the rulemaking process. As of the date this notice is published in the Notice Register, the rulemaking file consists of this Public Notice, the Text of the Proposed Regulations and the Initial Statement of Reasons. For further information regarding the inspection of the rulemaking file, contact Janee Marlan at (916) 653-6244 or Dustie Tice, the designated back-up contact, at (916) 653-6873. Copies of the rulemaking file may be obtained at www.ss.ca.gov/business or by contacting the contact person listed below.

AVAILABILITY OF CHANGED OR MODIFIED TEXT

Following the close of the public comment period, the Secretary of State may adopt the proposed regulations substantially as described in this notice. If the Secretary of State makes modifications which are sufficiently related to the originally proposed text, the modified text with changes clearly indicated shall be available to the public for at least 15 days before the Secretary of State adopts the regulations as revised. Please send requests for copies of any modified regulations to the contact person listed below. The Secretary of State will accept written comments on the modified regulations for 15 days after the date on which the modified regulations are made available. Once the final statement of reasons is prepared in accordance with subdivision (a) of Section 11346.9 of the Government Code copies may be obtained at www.ss.ca.gov/business or by contacting the contact person listed below.

CONTACT PERSON

Direct all written inquiries and requests for copies of the proposed text of the regulations, initial statement of reasons, modified text of regulations, if any, or other information upon which the rulemaking file is based to: Lisa B. Niegel, Regulation Coordinator, Office of the Secretary of State, Business Programs Division, 1500 11th Street, 2nd Floor, Sacramento, California 95814.